

ALLIANCE RESOURCE PARTNERS LP

Form 10-K

March 02, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NO.: 0-26823

ALLIANCE RESOURCE PARTNERS, L.P.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF

73-1564280
(IRS EMPLOYER
IDENTIFICATION NO.)

INCORPORATION OR ORGANIZATION)

1717 SOUTH BOULDER AVENUE, SUITE 400, TULSA, OKLAHOMA 74119

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES AND ZIP CODE)

(918) 295-7600

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

Securities registered pursuant to Section 12(b) of the Act: Common Units representing limited partner interests

Title of Each Class
Common Units

Name of Each Exchange On Which Registered
The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (check one)

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company)

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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The aggregate value of the common units held by non-affiliates of the registrant (treating all executive officers and directors of the registrant, for this purpose, as if they may be affiliates of the registrant) was approximately \$1,138,079,935 as of June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter, based on the reported closing price of the common units as reported on the NASDAQ Stock Market, LLC on such date.

As of February 23, 2009, 36,661,029 common units were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are intended to come within the safe harbor protection provided by those sections. These statements are based on our beliefs as well as assumptions made by, and information currently available to, us. When used in this document, the words anticipate, believe, continue, estimate, expect, forecast, may, project, will, and similar expressions identify statements. Without limiting the foregoing, all statements relating to our future outlook, anticipated capital expenditures, future cash flows and borrowings and sources of funding are forward-looking statements. These statements reflect our current views with respect to future events and are subject to numerous assumptions that we believe are reasonable, but are open to a wide range of uncertainties and business risks, and actual results may differ materially from those discussed in these statements. Among the factors that could cause actual results to differ from those in the forward-looking statements are:

increased competition in coal markets and our ability to respond to the competition;

sustained decreases in coal prices, which could adversely affect our operating results and cash flows;

risks associated with the expansion of our operations and properties;

deregulation of the electric utility industry or the effects of any adverse change in the coal industry, electric utility industry, or general economic conditions;

dependence on significant customer contracts, including renewing customer contracts upon expiration of existing contracts;

liquidity constraints, including those resulting from the cost or unavailability of financing due to current credit market conditions;

customer bankruptcies or cancellations or breaches to existing contracts;

customer delays or defaults in making payments;

fluctuations in coal demand, prices and availability due to labor and transportation costs and disruptions, equipment availability, governmental regulations, including those related to carbon emissions, and other factors;

legislation, regulatory and court decisions and interpretations thereof, including but not limited to issues related to climate change and miner health and safety;

our productivity levels and margins that we earn on our coal sales;

greater than expected increases in raw material costs;

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greater than expected shortage of skilled labor;

any unanticipated increases in labor costs, adverse changes in work rules, or unexpected cash payments associated with post-mine reclamation and workers' compensation claims;

any unanticipated increases in transportation costs and risk of transportation delays or interruptions;

greater than expected environmental regulation, costs and liabilities;

a variety of operational, geologic, permitting, labor and weather-related factors;

risks associated with major mine-related accidents, such as mine fires, or interruptions;

results of litigation, including claims not yet asserted;

difficulty maintaining our surety bonds for mine reclamation as well as workers' compensation and black lung benefits;

coal market's share of electricity generation;

prices of fuel that compete with or impact coal usage, such as oil or natural gas;

replacement of coal reserves;

a loss or reduction of direct or indirect benefits from certain state and federal tax credits;

difficulty obtaining commercial property insurance, and risks associated with our participation (excluding any applicable deductible) in the commercial insurance property program; and

other factors, including those discussed in Item 1A. Risk Factors and Item 3. Legal Proceedings.

If one or more of these or other risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results may differ materially from those described in any forward-looking statement. When considering forward-looking statements, you should also keep in mind the risk factors described in Risk Factors below. The risk factors could also cause our actual results to differ materially from those contained in any forward-looking statement. We disclaim any obligation to update the above list or to announce publicly the result of any revisions to any of the forward-looking statements to reflect future events or developments.

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You should consider the information above when reading any forward-looking statements contained:

in this Annual Report on Form 10-K;

other reports filed by us with the SEC;

our press releases; and

written or oral statements made by us or any of our officers or other authorized persons acting on our behalf.

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Significant Relationships Referenced in this Annual Report

References to we, us, our or ARLP Partnership mean the business and operations of Alliance Resource Partners, L.P., the parent company, as well as its consolidated subsidiaries.

References to ARLP mean Alliance Resource Partners, L.P., individually as the parent company, and not on a consolidated basis.

References to MGP mean Alliance Resource Management GP, LLC, the managing general partner of Alliance Resource Partners, L.P., also referred to as our managing general partner.

References to SGP mean Alliance Resource GP, LLC, the special general partner of Alliance Resource Partners, L.P., also referred to as our special general partner.

References to Intermediate Partnership mean Alliance Resource Operating Partners, L.P., the intermediate partnership of Alliance Resource Partners, L.P., also referred to as our intermediate partnership.

References to Alliance Coal mean Alliance Coal, LLC, the holding company for the operations of Alliance Resource Operating Partners, L.P., also referred to as our operating subsidiary.

References to AHGP mean Alliance Holdings GP, L.P., individually as the parent company, and not on a consolidated basis.

References to AGP mean Alliance GP, LLC, the general partner of Alliance Holdings GP, L.P.

PART I

ITEM 1. BUSINESS

General

We are a diversified producer and marketer of coal primarily to major U.S. utilities and industrial users. We began mining operations in 1971 and, since then, have grown through acquisitions and internal development to become what we believe to be the fifth largest coal producer in the eastern U.S.. At December 31, 2008, we had approximately 686.3 million tons of coal reserves in Illinois, Indiana, Kentucky, Maryland, Pennsylvania and West Virginia. In 2008, we produced 26.4 million tons of coal and sold 27.2 million tons of coal, of which 26.5% was low-sulfur coal, 11.0% was medium-sulfur coal and 62.5% was high-sulfur coal. In 2008, we sold 90.0% of our total tons to utility plants. We classify low-sulfur coal as coal with a sulfur content of less than 1%, medium-sulfur coal as coal with a sulfur content between 1% and 2%, and high-sulfur coal as coal with a sulfur content of greater than 2%.

We operate eight mining complexes in Illinois, Indiana, Kentucky, Maryland, and West Virginia. We are constructing two new mining complexes, one in Kentucky and one in West Virginia, and also operate a coal loading terminal on the Ohio River at Mt. Vernon, Indiana. Our mining activities are conducted in three geographic regions commonly referred to in the coal industry as the Illinois Basin, Central Appalachian and Northern Appalachian regions. We have grown historically, and expect to grow in the future, through expansion of our operations by adding and developing mines and coal reserves in these regions.

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ARLP is a Delaware limited partnership listed on the NASDAQ Global Select Market under the ticker symbol ARLP. ARLP was formed in May 1999 to acquire, upon completion of ARLP's initial public offering on August 19, 1999, certain coal production and marketing assets of Alliance Resource Holdings, Inc., a Delaware corporation (ARH), consisting of substantially all of ARH's operating subsidiaries, but excluding ARH. ARH was previously owned by current and former management of the ARLP Partnership. In June 2006, our special general partner, SGP, and its parent, ARH, became wholly-owned, directly and indirectly, by Joseph W. Craft, III, the President and Chief Executive Officer and a Director of our managing general partner. SGP, a Delaware limited liability company, holds a 0.01% general partner interest in each of ARLP and the Intermediate Partnership.

We are managed by our managing general partner, MGP, a Delaware limited liability company, which holds a 0.99% and 1.0001% managing general partner interest in ARLP and the Intermediate Partnership, respectively. AHGP is a Delaware limited partnership that was formed to become the owner and controlling member of MGP. AHGP completed its initial public offering (AHGP IPO) on May 15, 2006 and is listed on the NASDAQ Global Select Market under the ticker symbol AHGP. AHGP owns, directly and indirectly, 100% of the members' interest of MGP, a 0.001% managing interest in Alliance Coal, the incentive distribution rights (IDR) in ARLP and 15,544,169 common units of ARLP. The following diagram depicts our organization and ownership as of December 31, 2008:

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- (1) The Management Group is comprised of current and former members of our management, who are the former indirect owners of MGP, and their affiliates.
- (2) The units held by SGP and most of the units held by the Management Group are subject to a transfer restriction agreement that, subject to a number of exceptions (including certain transfers by Mr. Craft in which the other parties to the agreement are entitled or required to participate), prohibits the transfer of such units unless approved by a majority of the disinterested members of the board of directors of AGP pursuant to certain procedures set forth in the agreement.

Our internet address is www.arlp.com, and we make available free of charge on our website our Annual Reports on Form 10-K, our Quarterly Reports on Form 10-Q, our Current Reports on Form 8-K and Forms 3, 4 and 5 for our Section 16 filers (and amendments and exhibits, such as press releases, to such filings) as soon as reasonably practicable after we electronically file with or furnish such material to the Securities and Exchange Commission. Information on our website or any other website is not incorporated by reference into this report and does not constitute a part of this report.

We file or furnish annual, quarterly and current reports, proxy statements and other documents with the U.S. Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (Exchange Act). The public may read and copy any materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers, including us, that file electronically with the SEC. The public can obtain any documents that we file with the SEC at <http://www.sec.gov>.

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We produce a diverse range of steam coals with varying sulfur and heat contents, which enables us to satisfy the broad range of specifications required by our customers. The following chart summarizes our coal production by region for the last five years.

Regions and Complexes	Year Ended December 31,				
	2008	2007	2006	2005	2004
	(tons in millions)				
Illinois Basin:					
Dotiki, Warrior, Pattiki, Hopkins and Gibson complexes	20.3	17.9	16.9	15.7	13.6
Central Appalachian:					
Pontiki and MC Mining complexes	3.2	3.2	3.5	3.3	3.6
Northern Appalachian:					
Mettiki complex	2.9	3.2	3.3	3.3	3.2
Total	26.4	24.3	23.7	22.3	20.4

The following map shows the location of our mining complexes:

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Illinois Basin Operations

Our Illinois Basin mining operations are located in western Kentucky, southern Illinois and southern Indiana. We have approximately 2,025 employees in the Illinois Basin and currently operate five mining complexes and have one mining complex under construction.

Dotiki Complex. Our subsidiary, Webster County Coal, LLC (Webster County Coal), operates Dotiki, which is an underground mining complex located near the city of Providence in Webster County, Kentucky. The complex was opened in 1966, and we purchased the mine in 1971. The Dotiki complex utilizes continuous mining units employing room-and-pillar mining techniques to produce high-sulfur coal. Dotiki's preparation plant has throughput capacity of 1,300 tons of raw coal an hour. Coal from the Dotiki complex is shipped via the CSX Transportation, Inc. (CSX) and Paducah & Louisville Railway, Inc. (PAL) railroads and by truck on U.S. and state highways directly to customers or to various transloading facilities, including our Mt. Vernon Transfer Terminal, LLC (Mt. Vernon) transloading facility, for sale to customers capable of receiving barge deliveries.

Warrior Complex. Our subsidiary, Warrior Coal, LLC (Warrior), operates an underground mining complex located near the city of Madisonville in Hopkins County, Kentucky. The Warrior complex was opened in 1985 and acquired by us in February 2003. Warrior utilizes continuous mining units employing room-and-pillar mining techniques to produce high-sulfur coal. Warrior's preparation plant has throughput capacity of 600 tons of raw coal an hour. We are currently constructing a new preparation plant, which is expected to be operational in the first quarter of 2009 and will have throughput capacity of 1,200 tons of raw coal an hour. Warrior's production can be shipped via the CSX and PAL railroads and by truck on U.S. and state highways directly to customers or to various transloading facilities, including our Mt. Vernon transloading facility, for sale to customers capable of receiving barge deliveries.

Pattiki Complex. Our subsidiary, White County Coal, LLC (White County Coal), operates Pattiki, an underground mining complex located near the city of Carmi in White County, Illinois. We began construction of the complex in 1980 and have operated it since its inception. The Pattiki complex utilizes continuous mining units employing room-and-pillar mining techniques to produce high-sulfur coal. The preparation plant has throughput capacity of 1,000 tons of raw coal an hour. Coal from the Pattiki complex is shipped via the Evansville Western Railway, Inc. (EVW) railroad directly to customers or to various transloading facilities, including our Mt. Vernon transloading facility, for sale to customers capable of receiving barge deliveries.

Hopkins Complex. The Hopkins complex, which we acquired in January 1998, is located near the city of Madisonville in Hopkins County, Kentucky. It is operated by our subsidiary, Hopkins County Coal, LLC (Hopkins County Coal). During 2006, Hopkins County Coal ceased production from its Newcoal surface mine, which is being reclaimed, and began operations at its Elk Creek underground mine using continuous mining units employing room-and-pillar mining techniques to produce high-sulfur coal. Coal produced from the Elk Creek mine is processed and shipped through Hopkins County Coal's preparation plant, which has throughput capacity of 1,200 tons of raw coal an hour. Elk Creek's production can be shipped via the CSX and PAL railroads and by truck on U.S. and state highways directly to customers or to various transloading facilities, including our Mt. Vernon transloading facility, for sale to customers capable of receiving barge deliveries.

Gibson Complex. Our subsidiary, Gibson County Coal, LLC (Gibson County Coal), operates the Gibson mine, an underground mining complex located near the city of Princeton in Gibson County, Indiana. The mine began production in November 2000 and utilizes continuous mining units employing room-and-pillar mining techniques to produce low-sulfur coal. The preparation plant has throughput capacity of 700 tons of raw coal an hour. We refer to the reserves mined at this location as the Gibson North reserves. We also control undeveloped reserves in Gibson County that are not contiguous to the reserves currently being mined, which we refer to as the Gibson South reserves. See Gibson South Reserves discussed below.

Production from Gibson is low-sulfur coal that is either shipped by truck on U.S. and state highways or transported by rail on CSX and Norfolk Southern Railway Company (NS) railroads directly to customers or to various transloading facilities, including our Mt. Vernon transloading facility, for sale to customers capable of receiving barge deliveries.

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River View Complex. In April 2006, we acquired River View Coal, LLC (River View) from ARH. River View currently controls, through coal leases or direct ownership, approximately 105.4 million tons of proven and probable high-sulfur coal in the Kentucky No. 7, No. 9 and No. 11 coal seams underlying properties located primarily in Union County, Kentucky, as well as certain surface properties, facilities and permits. In July 2007, we began construction of the slope and shaft at River View and, in April 2008, the board of directors of our managing general partner (Board of Directors) gave final approval for development of the mining complex. We are developing River View as an underground mining complex with the capacity for up to eight continuous mining units employing room-and-pillar mining techniques. Capital expenditures required to develop the River View mine are estimated to range from approximately \$250 to \$275 million for an eight unit operation, excluding capitalized interest and capitalized mine development costs. (For more information about mine development costs, please read Mine Development Costs under Item 8. Financial Statements and Supplementary Data Note 2. Summary of Significant Accounting Policies.) River View's preparation plant will have throughput capacity of 1,800 tons of raw coal per hour. Coal produced from the River View mine will be transported by overland belt to a barge loading facility on the Ohio River (mile marker 843). Initial production is expected to commence in the second half of 2009. We expect that annual production capacity of the River View mine will be approximately 6.4 million tons.

Gibson South Reserves. We have partially completed the permitting process for the Gibson South reserves and we continue to evaluate development of the project. (For more information on the permitting process, and matters that could hinder or delay the process, please read Regulation and Laws Mining Permits and Approvals.) Development of the project continues to be market dependent, and its timing is open-ended pending sufficient coal sales commitments to support the project. We expect the mine to be operated by our subsidiary, Gibson County Coal (South), LLC (Gibson South). We expect the mine to be developed as an underground mining complex using continuous mining units employing room-and-pillar techniques, and to have an annual production capacity of approximately 3.0 million to 3.5 million tons. Definitive development commitment for Gibson South is dependent upon final approval by the Board of Directors.

Central Appalachian Operations

Our Central Appalachian mining operations are located in eastern Kentucky. We have approximately 530 employees in Central Appalachia and operate two mining complexes.

Pontiki Complex. The Pontiki complex is located near the city of Inez in Martin County, Kentucky. We constructed the mine in 1977. Our subsidiary, Pontiki Coal, LLC (Pontiki), owns the mining complex and controls the reserves, and our subsidiary, Excel Mining, LLC (Excel), conducts all mining operations. The underground operation utilizes continuous mining units employing room-and-pillar mining techniques to produce low-sulfur coal. The preparation plant has throughput capacity of 900 tons of raw coal an hour. Coal produced in 2008 remained low sulfur, but does not meet the compliance requirements of Phase II of the Federal Clean Air Act (CAA) (see Regulation and Laws Air Emissions below). Coal produced from the mine is shipped via the NS railroad directly to customers or to various transloading facilities on the Ohio River for sale to customers capable of receiving barge deliveries, or by truck via U.S. and state highways directly to customers or various docks on the Big Sandy River for shipment to customers capable of receiving barge deliveries.

MC Mining Complex. The MC Mining complex is located near the city of Pikeville in Pike County, Kentucky. We acquired the mine in 1989. Our subsidiary, MC Mining, LLC (MC Mining), owns the mining complex and leases the reserves, and Excel conducts all mining operations. The underground operation utilizes continuous mining units employing room-and-pillar mining techniques to produce low-sulfur coal. The preparation plant has throughput capacity of 1,000 tons of raw coal an hour. Substantially all of the coal produced at MC Mining in 2008 met or exceeded the compliance requirements of Phase II of the CAA. Coal produced from the mine is shipped via the CSX railroad directly to customers or to various transloading facilities on the Ohio River for sale to customers capable of receiving barge deliveries, or by truck via U.S. and state highways directly to customers or various docks on the Big Sandy River for shipment to customers capable of receiving barge deliveries.

Northern Appalachian Operations

Our Northern Appalachian mining operations employ approximately 240 employees and are located in Maryland and West Virginia. We operate one mining complex and have one mining complex under construction in Northern Appalachia. We also control undeveloped reserves in West Virginia and Pennsylvania.

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Mettiki (MD) Operation. Our subsidiary, Mettiki Coal, LLC (Mettiki (MD)), previously operated an underground longwall mine located near the city of Oakland in Garrett County, Maryland. Underground longwall mining operations ceased at this mine in October 2006 upon the exhaustion of the economically mineable reserves, and the longwall mining equipment was moved from the Mettiki (MD) operation to the operation of our subsidiary, Mettiki Coal (WV), LLC (Mettiki (WV)) (discussed below). Medium-sulfur coal produced from two small-scale third-party mining operations (a surface strip mine and an underground mine) on properties controlled by Mettiki (MD) and another of our subsidiaries, Backbone Mountain, LLC, supplements the Mettiki (WV) production, providing blending optimization and allowing the operation to take advantage of market opportunities as they arise.

Our Mettiki (MD) preparation plant has throughput capacity of 1,350 tons of raw coal an hour. A portion of the Mettiki (WV) production is transported to this preparation plant for processing and then trucked to a blending facility at the Virginia Electric and Power Company (VEPCO) Mt. Storm Power Station. The preparation plant also is served by the CSX railroad, providing the opportunity to capitalize on the metallurgical coal market.

Mettiki (WV) Operation. In July 2005, Mettiki (WV) began continuous miner development of the Mountain View mine located in Tucker County, West Virginia. Upon completion of mining at the Mettiki (MD) longwall operation, the longwall mining equipment was moved to the Mountain View mine and put into operation in November 2006. The Mountain View mine produces medium-sulfur coal which is transported by truck either to the Mettiki (MD) preparation plant (which is served by CSX) or to the coal blending facility at the VEPCO Mt. Storm Power Station.

Tunnel Ridge Complex. Our subsidiary, Tunnel Ridge, LLC (Tunnel Ridge), controls, through a coal lease agreement with our special general partner, approximately 70.5 million tons of proven and probable high-sulfur coal in the Pittsburgh No. 8 coal seam in West Virginia and Pennsylvania. An underground mining permit was issued to us by the West Virginia Department of Environmental Protection on February 12, 2007, and we either have received or have applications pending for all permits necessary to conduct operations. (For more information on the permitting process, and matters that could hinder or delay the process, please read Regulation and Laws *Mining Permits and Approvals.*) In September of 2008, the Board of Directors gave final approval for development of the reserves, and we have begun construction of the mining complex, which will be an underground, longwall mine. Capital expenditures required for development are estimated to be in the range of approximately \$265 million to \$285 million, excluding capitalized interest and capitalized mine development costs. (For more information about mine development costs, please read Mine Development Costs under Item 8. Financial Statements and Supplementary Data Note 2. Summary of Significant Accounting Policies.) We expect to begin longwall mining operations at Tunnel Ridge in the second half of 2010 or in 2011, and we expect annual production capacity of the mine to ultimately reach approximately 5.5 to 6.0 million tons.

Penn Ridge. Our subsidiary, Penn Ridge Coal, LLC (Penn Ridge), is party to a coal lease agreement effective December 31, 2005 with Allegheny Pittsburgh Coal Company (Allegheny), pursuant to which Penn Ridge leases Allegheny's Buffalo coal reserve in Washington County, Pennsylvania, which is estimated to include approximately 56.7 million tons of proven and probable high-sulfur coal in the Pittsburgh No. 8 seam. We have initiated the permitting process for the Buffalo coal reserves and continue to evaluate development. (For more information on the permitting process, and matters that could hinder or delay the process, please read Regulation and Laws *Mining Permits and Approvals.*) Development of the project continues to be market dependent, and its timing is open-ended pending sufficient coal sales commitments to support the project. It is expected that these reserves will be developed as an underground mining complex using either continuous mining units employing room-and-pillar techniques, longwall mining, or both. We expect the annual production capacity of the Penn Ridge mine to be approximately 2.5 to 3.0 million tons utilizing continuous mining units or up to 5.0 million tons with longwall mining. Definitive development commitment for Penn Ridge is dependent upon final approval by the Board of Directors.

Other Operations

Mt. Vernon Transfer Terminal, LLC

Our subsidiary, Mt. Vernon, leases land and operates a coal loading terminal on the Ohio River (mile marker 827.5) at Mt. Vernon, Indiana. Coal is delivered to Mt. Vernon by both rail and truck. The terminal has a capacity of 8.0 million tons per year with existing ground storage of approximately 60,000 to 70,000 tons. During 2008, the terminal loaded approximately 2.2 million tons for customers of Pattiki, Gibson, and Elk Creek and for third parties.

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Coal Brokerage

As markets allow, we buy coal from non-affiliated producers principally throughout the eastern U.S., which we then resell. We have a policy of matching our outside coal purchases and sales to minimize market risks associated with buying and reselling coal. We did not have any transactions in 2008 classified as brokerage coal in our financial results.

Matrix Design Group, LLC

Our subsidiaries, Matrix Design Group, LLC and Alliance Design Group, LLC (collectively, "MDG"), provide a variety of mine products and services for our mining operations and to unrelated parties. We acquired this business in September 2006. MDG's products and services include design and installation of underground mine hoists for transporting employees and materials in and out of mines; design of systems for automating and controlling various aspects of industrial and mining environments; and design and sale of mine safety equipment, including its miner and equipment tracking system. In 2008, our financial results were not significantly impacted by MDG's activities.

Additional Services

We develop and market additional services in order to establish ourselves as the supplier of choice for our customers. Examples of the kind of services we have offered to date include ash and scrubber sludge removal, coal yard maintenance and arranging alternate transportation services. Revenues from these services have historically represented less than one percent of our total revenues. In addition, our affiliate, Mid-America Carbonates, LLC ("MAC"), which is a joint venture in which White County Coal participates, manufactures and sells rock dust to us and to unrelated parties. In 2008, our financial results were not significantly impacted by MAC's business. Please read Item 8. Financial Statements and Supplementary Data Note 18. Minority Interest.

Reportable Segments

Please read Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, and Segment Information under Item 8. Financial Statements and Supplementary Data Note 22. Segment Information for information concerning our reportable segments.

Synfuel Facilities

For several years, three of our mining complexes—the Warrior Complex and the Gibson Complex in the Illinois Basin Region and the Mettiki Complex in the Northern Appalachian Region—supplied coal feedstock and provided services to third-party coal synfuel facilities located at or near these complexes. Our agreements with those third-parties terminated on December 31, 2007 coincident with the expiration of the federal non-conventional source fuel tax credit and, as a result, we no longer supply feedstock or provide services to those facilities. In 2007, the incremental net income benefit to us from these synfuel-related agreements was approximately \$28.5 million.

Coal Marketing and Sales

As is customary in the coal industry, we have entered into long-term coal supply agreements with many of our customers. These arrangements are mutually beneficial to us and our customers in that they provide greater predictability of sales volumes and sales prices. In 2008, approximately 94.8% and 98.9% of our sales tonnage and total coal sales, respectively, were sold under long-term contracts (contracts having a term of one year or greater) with maturities ranging from 2009 to 2023. Our total nominal commitment under significant long-term contracts for existing operations was approximately 106.3 million tons at December 31, 2008, and is expected to be delivered as follows: 26.0 million tons in 2009, 25.3 million tons in 2010, 22.9 million tons in 2011, and 32.1 million tons thereafter during the remaining terms of the relevant coal supply agreements. The total commitment of coal under contract is an approximate number because, in some instances, our contracts contain provisions that could cause the nominal total commitment to increase or decrease by as much as 20%. The contractual time commitments for customers to nominate future purchase volumes under these contracts are typically sufficient to allow us to balance our sales commitments with prospective production capacity. In addition, the nominal total commitment can otherwise change because of reopener provisions contained in certain of these long-term contracts.

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The provisions of long-term contracts are the results of both bidding procedures and extensive negotiations with each customer. As a result, the provisions of these contracts vary significantly in many respects, including, among others, price adjustment features, price and contract reopener terms, permitted sources of supply, force majeure provisions, coal qualities and quantities. Virtually all of our long-term contracts are subject to price adjustment provisions, which permit an increase or decrease periodically in the contract price to reflect changes in specified price indices or items such as taxes, royalties or actual production costs. These provisions, however, may not assure that the contract price will reflect every change in production or other costs. Failure of the parties to agree on a price pursuant to an adjustment or a reopener provision can lead to early termination of a contract. Some of the long-term contracts also permit the contract to be reopened for renegotiation of terms and conditions other than the pricing terms, and where a mutually acceptable agreement on terms and conditions cannot be concluded, either party may have the option to terminate the contract. The long-term contracts typically stipulate procedures for transportation of coal, quality control, sampling and weighing. Most contain provisions requiring us to deliver coal within stated ranges for specific coal characteristics such as heat, sulfur, ash, moisture, grindability, volatility and other qualities. Failure to meet these specifications can result in economic penalties or termination of the contracts. While most of the contracts specify the approved seams and/or approved locations from which the coal is to be mined, some contracts allow the coal to be sourced from more than one mine or location. Although the volume to be delivered pursuant to a long-term contract is stipulated, the buyers often have the option to vary the volume within specified limits.

Reliance on Major Customers

Our four largest customers in 2008 were VEPCO, Louisville Gas and Electric Company, Tennessee Valley Authority and Seminole Electric Cooperative, Inc. During 2008, we derived approximately 46.8% of our total revenues from these four customers and at least 10.0% of our total revenues from each of the four. For more information about these customers, please read Item 8. Financial Statements and Supplementary Data Note 21. Concentration of Credit Risk and Major Customers.

Competition

The coal industry is intensely competitive. The most important factors on which we compete are coal quality (including sulfur and heat content), transportation costs from the mine to the customer and the reliability of supply. Our principal competitors include Alpha Natural Resources, Inc., Arch Coal, Inc., CONSOL Energy, Inc., Foundation Coal Holdings, Inc., International Coal Group, Inc., James River Coal Company, Massey Energy Company, Murray Energy, Inc., Patriot Coal Corporation and Peabody Energy Corp. Some of these coal producers are larger and have greater financial resources and larger reserve bases than we do. We also compete directly with a number of smaller producers in the Illinois Basin, Central Appalachian and Northern Appalachian regions. As the price of domestic coal increases, we may also begin to compete with companies that produce coal from one or more foreign countries.

Additionally, coal competes with other fuels such as petroleum, natural gas, nuclear energy and renewable energy sources for electrical power generation. Over time, costs and other factors, such as safety and environmental considerations, may affect the overall demand for coal as a fuel.

Transportation

Our coal is transported to our customers by rail, truck and barge. Depending on the proximity of the customer to the mine and the transportation available for delivering coal to that customer, transportation costs can range from 6.0% to 65.0% of the total delivered cost of a customer's coal. As a consequence, the availability and cost of transportation constitute important factors in the marketability of coal. We believe our mines are located in favorable geographic locations that minimize transportation costs for our customers, and in many cases we are able to accommodate transportation options. Typically, our customers pay the transportation costs from the mining complex to the destination, which is the standard practice in the industry. Approximately 71.1% of our 2008 sales volume was initially shipped from the mines by rail with the remainder leaving the mines by truck. In 2008, the largest volume transporter of our coal shipments was the CSX, which moved approximately 37.1% of our tonnage over its rail system. The practices of, and rates set by, the transportation company serving a particular mine or customer may affect, either adversely or favorably, our marketing efforts with respect to coal produced from the relevant mine.

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Regulation and Laws

The coal mining industry is subject to regulation by federal, state and local authorities on matters such as:

employee health and safety;

mine permits and other licensing requirements;

air quality standards;

water quality standards;

storage of petroleum products and substances which are regarded as hazardous under applicable laws or which, if spilled, could reach waterways or wetlands;

plant and wildlife protection;

reclamation and restoration of mining properties after mining is completed;

the discharge of materials into the environment;

storage and handling of explosives;

wetlands protection;

surface subsidence from underground mining; and

the effects, if any, that mining has on groundwater quality and availability.

In addition, the utility industry is subject to extensive regulation regarding the environmental impact of its power generation activities, which could affect demand for our coal. It is possible that new legislation or regulations may be adopted, or that existing laws or regulations may be differently interpreted or more stringently enforced, any of which could have a significant impact on our mining operations or our customers ability to use coal.

We are committed to conducting mining operations in compliance with applicable federal, state and local laws and regulations. However, because of the extensive and detailed nature of these regulatory requirements, it is extremely difficult for us and other underground coal mining companies in particular, as well as the coal industry in general, to comply with all requirements at all times. None of our violations to date has had a material impact on our operations or financial condition. While it is not possible to quantify all of the costs of compliance with applicable federal and state laws and associated regulations, those costs have been and are expected to continue to be significant. Compliance with these laws and regulations has substantially increased the cost of coal mining for domestic coal producers.

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Capital expenditures for environmental matters have not been material in recent years. We have accrued for the present value of the estimated cost of asset retirement obligations and mine closings, including the cost of treating mine water discharge, when necessary. The accruals for asset retirement obligations and mine closing costs are based upon permit requirements and the costs and timing of asset retirement obligations and mine closing procedures. Although management believes it has made adequate provisions for all expected reclamation and other costs associated with mine closures, future operating results would be adversely affected if we later determine these accruals to be insufficient.

Mining Permits and Approvals

Numerous governmental permits or approvals are required for mining operations. Applications for permits require extensive engineering and data analysis and presentation, and must address a variety of environmental, health, and safety matters associated with a proposed mining operation. These matters include the manner and sequencing of coal extraction, the storage, use and disposal of waste and other substances and other impacts on the environment, the construction of water containment areas, and reclamation of the area after coal extraction. Meeting all requirements imposed by any of these authorities may be costly and time consuming, and may delay or prevent commencement or continuation of mining operations in certain locations.

As is typical in the coal industry, we strive to obtain mining permits within a time frame that allows us to mine reserves as planned on an uninterrupted basis. Typically, we commence actions to obtain permits between 18 and 24 months before we plan to mine a new area. In our experience, permits generally are approved within 12 to 18 months after a completed application is submitted, although regulatory authorities exercise considerable discretion in the timing and scope of permit issuance and the public has rights to engage in the permitting process, including intervention in the courts, which can cause delay. Generally, we have not experienced material difficulties in obtaining mining permits in the areas where our reserves are located. However, the permitting process for certain mining operations has extended over several years and we cannot assure you that we will not experience difficulty or delays in obtaining mining permits in the future.

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We are required to post bonds to secure performance under our permits. Under some circumstances, substantial fines and penalties, including revocation of mining permits, may be imposed under the laws and regulations described above. Monetary sanctions and, in severe circumstances, criminal sanctions may be imposed for failure to comply with these laws and regulations. Regulations also provide that a mining permit can be refused or revoked if the permit applicant or permittee owns or controls, directly or indirectly through other entities, mining operations that have outstanding environmental violations. Although, like other coal companies, we have been cited for violations in the ordinary course of our business, we have never had a permit suspended or revoked because of any violation, and the penalties assessed for these violations have not been material.

Two townships in Pennsylvania, Donegal and Blaine, enacted ordinances that purport to prohibit all coal mining activities within the townships, invalidate mining permits issued by any state or federal government entity, and, in some instances, require divestiture of all currently held coal property interests. Some of the coal reserves of our Tunnel Ridge and Penn Ridge subsidiaries are located within these townships. We believe these ordinances violate several provisions of the U.S. Constitution and the Pennsylvania Constitution as well as federal and state mining laws. We, along with other affected parties, initiated legal action in April 2008 seeking to have the Donegal ordinances invalidated. The Donegal Township subsequently rescinded its ordinances. In October 2008, we, along with other affected parties, initiated legal action seeking to have the Blaine ordinances invalidated. We believe this litigation also will be successful. However, in the event it is not and Blaine's ordinances are not repealed, these ordinances would prevent mining our properties within the Blaine Township which could adversely affect our results of operation and financial condition.

Mine Health and Safety Laws

Stringent safety and health standards have been imposed by federal legislation since 1969 when the Federal Coal Mine Health and Safety Act of 1969 (CMHSA) was adopted. The Federal Mine Safety and Health Act of 1977 (FMSHA), and regulations adopted pursuant thereto, significantly expanded the enforcement of health and safety standards of the CMHSA, and imposed extensive and detailed safety and health standards on numerous aspects of mining operations, including training of mine personnel, mining procedures, blasting, the equipment used in mining operations, and numerous other matters. The Mine Safety and Health Administration (MSHA) monitors and rigorously enforces compliance with these federal laws and regulations. In addition, as part of the FMSHA, the Federal Black Lung Benefits Act (BLBA) requires payments of benefits by all businesses that conduct current mining operations to coal miners with black lung disease and to some survivors of miners who die from this disease. Most of the states where we operate also have state programs for mine safety and health regulation and enforcement. In combination, federal and state safety and health regulation in the coal mining industry is perhaps the most comprehensive and rigorous system for protection of employee safety and health affecting any segment of any industry, and this regulation has a significant effect on our operating costs. Although many of the requirements primarily impact underground mining, our competitors in all of the areas in which we operate are subject to the same laws and regulations.

In 2006, the Federal Mine Improvement and New Emergency Response Act of 2006 (MINER Act) was enacted. The MINER Act significantly amended the FMSHA, imposing more extensive and stringent compliance standards, increasing criminal penalties and establishing a maximum civil penalty for non-compliance, and expanding the scope of federal oversight, inspection, and enforcement activities. Following the passage of the MINER Act, MSHA has issued new or more stringent rules and policies on a variety of topics, including:

sealing off abandoned areas of underground coal mines;

mine safety equipment, training and emergency reporting requirements;

substantially increased civil penalties for regulatory violations;

training and availability of mine rescue teams;

underground refuge alternatives capable of sustaining trapped miners in the event of an emergency;

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flame-resistant conveyor belt, fire prevention and detection, and use of air from the belt entry; and

post-accident two-way communications and electronic tracking systems.

Subsequent to passage of the MINER Act, Illinois, Kentucky, Pennsylvania and West Virginia have enacted legislation addressing issues such as mine safety and accident reporting, increased civil and criminal penalties, and increased inspections and oversight. Other states may pass similar legislation in the future. Also, there is pending federal

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legislation that would impose additional safety and health requirements on coal mining. Although we are unable to quantify the full impact, implementing and complying with these new laws and regulations have and are expected to continue to have an adverse impact on our results of operation and financial position.

Black Lung Benefits Act

The BLBA levies a tax on production of \$1.10 per ton for underground-mined coal and \$0.55 per ton for surface-mined coal, but not to exceed 4.4% of the applicable sales price, in order to compensate miners who are totally disabled due to black lung disease and some survivors of miners who died from this disease, and who were last employed as miners prior to 1970 or subsequently where no responsible coal mine operator has been identified for claims. In addition, BLBA provides that some claims for which coal operators had previously been responsible are or will become obligations of the government trust funded by the tax. The Revenue Act of 1987 extended the termination date of this tax from January 1, 1996, to the earlier of January 1, 2014, or the date on which the government trust becomes solvent. For miners last employed as miners after 1969 and who are determined to have contracted black lung, we self-insure the potential cost of compensating such miners using our actuary estimates of the cost of present and future claims. We are also liable under state statutes for black lung claims.

Revised BLBA regulations took effect in January 2001, relaxing the stringent award criteria established under previous regulations and thus potentially allowing more new federal claims to be awarded and allowing previously denied claimants to re-file under the revised criteria. These regulations may also increase black lung related medical costs by broadening the scope of conditions for which medical costs are reimbursable, and increase legal costs by shifting more of the burden of proof to the employer. Moreover, Congress and state legislatures regularly consider various items of black lung legislation that, if enacted, could adversely affect our business, financial condition, and results of operation.

Workers Compensation

We are required to compensate employees for work-related injuries. Several states in which we operate consider changes in workers compensation laws from time to time. We generally self-insure this potential expense using our actuary estimates of the cost of present and future claims. For more information concerning our requirement to maintain bonds to secure our workers compensation obligations, see the discussion of surety bonds below under Surface Mining Control and Reclamation Act.

Coal Industry Retiree Health Benefits Act